

**INDONESIA'S NEW REGULATIONS
ON OIL, GAS AND ENERGY**

Constitutional Court annulment of new Electricity Law: a setback for investment?

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I. Introduction

Recent regulatory developments concerning Indonesia's oil, gas, mining and energy sector have been oriented towards abolishing the monopolistic practices long enjoyed by state-owned companies by opening this sector to market competition.

In November of 2001, a new law governing Indonesia's oil and gas industry, Law No. 22 of 2001, was passed by the nation's Parliament. This new law brings to an end the monopoly long held by the national oil company, Pertamina, in this key sector and revokes previous legislation on oil and gas, namely: (i) Law No. 44 of 1960, which stipulated that only national enterprises may exploit petroleum and natural gas; (ii) Law No. 15 of 1962 regarding the obligation of oil companies to meet domestic demand; and (iii) Law No. 8 of 1971, as amended in 1974, on state-owned oil and gas mining companies. The new law serves as a framework document, requiring further regulations for its implementation. Consequently, a series of implementing regulations have since been promulgated.

Almost a year later, in September of 2002, the Government issued Law No. 20 of 2002 on Electricity. This law revoked Electricity Law No. 15 of 1985. However, in December of 2004, the Constitutional Court declared this law to be contrary to the

nation's Constitution in that it opened the door for full competition in the electricity business.

This brief paper will provide a summary of each law and their respective implementing regulations, in an attempt to describe the current trend in the legal and regulatory regime of these key areas in Indonesia.

II. The New Oil and Gas Law

As mentioned earlier, Law No. 22 of 2001 replaces the previous regulations on oil and gas. The old laws became null and void, except to the extent that they contain regulations which are not contrary to the new law. Nevertheless, all existing contracts entered into under the previous legislation will remain in effect and be honored until their respective expiration dates.

The new oil and gas law divides activities in this sector into Upstream and Downstream Business. The former covers exploration and exploitation of oil and gas: the extraction of the resources; whereas the latter covers the processing, transportation, storage, marketing and trading of the products of those resources. Upstream Business will now be controlled and administered through Cooperation Contracts, which need to be reported to the Parliament, while to engage in Downstream Business only the appropriate business license, issued by the Minister, is required. Foreign business entities may engage only in Upstream Business.

In order to supervise the Upstream Business, the Government formed an Implementing Body, *Badan Pelaksana Minyak dan Gas Bumi* (generally known as “*BP MIGAS*”) by virtue of Government Regulation No. 42 of 2002. This Government Regulation covers the formation, status, assets, funding, management, organization, human resources and budget of the Implementing Body.

To supervise and govern Downstream Business, the Government formed a Regulatory Body called *Badan Pengatur*, pursuant to Government Regulation No. 67 of 2002, concerning the Regulatory Body on Providing and Distributing Oil Fuel and Transportation of Natural Gas through Pipes. Government Regulation No. 86 of 2002, issued on the same date, sets out the mechanism for establishing this Regulatory Body.

The Upstream Business is implemented through Government Regulation No. 35 of 2004 on Upstream Oil and Gas Business Activities, which limits the activities of a business entity in this sector to a single Work Territory and gives the Minister the authority to grant approvals to business entities to act as contractors in the Upstream Business. The New Law of 2001 also specifies that a business entity may only obtain control over one Work Territory. A Cooperation Contract is valid up to thirty years, with a possible extension of an additional twenty years, so that the maximum contract period under the new law is fifty years. This time frame is similar to that under the previous legislation. The contract period referred to above covers both exploration and exploitation phases. The exploration period is limited to six years, with a possible extension of up to an additional four. Government Regulation 35/2004 further stipulates that any business entity which has obtained approval to develop a field in a Work Territory but fails to perform any activity within five years after the end of an exploration period, must return the entire Work Territory to the Minister.

As for Downstream Business, Government Regulation No. 36 of 2004 governs, and provides, *inter alia*, that: (i) downstream Business shall be operated by a business entity which has obtained a Business License issued by the Minister, based on fair, healthy, and transparent competition; and (ii) the Minister shall stipulate a policy on quantity and type of National Oil Fuel Reserves which must meet the standard and quality as determined by the Minister. The Minister shall also determine type, standard, and quality of oil fuel, gas fuel, and/or processing

output. Furthermore, to guarantee the availability and distribution of certain types of oil fuel, trading business shall be operated based on fair, healthy, and transparent competition, which in practice is implemented gradually.

In the spirit of improving competition in this sector, the new law brings to an end the monopoly previously held by Pertamina. Pertamina is no longer the sole player in the downstream oil business. Competition is now open for new players, both national and multinational companies. Pertamina will be removed as the country's oil and gas administrator, state partner and negotiator, to be replaced by the Implementing Body. In June 2003, the Government promulgated Government Regulation No. 31 of 2003 on the conversion of Pertamina into a *Persero*, a state-owned, limited-liability company.

During 2002-2005, the transitional period after the issuance of the new law, Pertamina will continue to supply and distribute the domestic fuel requirement. Pertamina is also expected to take responsibility for the supply and distribution of fuel and other refined products in the outlying and pocket areas of Indonesia where new competitors are not expected to operate.

The new Oil and Gas Law of 2002 also contains other obligations such as the requirement to provide up to 25% of the production to the domestic market and the obligation that all data acquired through general survey, exploration, and exploitation belongs to and is owned by the Government.

III. Legal Developments in Electricity

In September of 2002, Law No. 20 of 2002 on Electricity was passed by the Indonesian Parliament. This law was intended to replace the previous Electricity Law, Law No. 15 of 1985, and convey the spirit of introducing more competition into the market. The elucidation of this new law clearly stated that the law was

promulgated not only to enhance the provision of electricity in an adequate and economic manner, but also to improve competition in the electric power market.

However, in December of 2004, the Constitutional Court annulled this law, and reinstated the outdated Electricity Law, No. 15 of 1985. In its decision, the Constitutional Court set out its reasoning, as follows: since electricity is an important commodity, essential to the lives of the populace, electricity should remain under the government's control. Also, it is contrary to the nation's Constitution to open the door to full competition in the electricity business. Article 33 of Indonesia's 1945 Constitution provides that ". . . *economic sectors which are important to the state and crucial for the welfare of the people shall be controlled by the state and must be developed to give the maximum benefit to the people.*" The Constitutional Court took the view that electricity is one of those sectors that need to be controlled by the state, and apparently that closing the door to foreign participation would result in the maximum benefit to the people.

Both the now-defunct new law of 2002 and the old law of 1985 divide the activities of the electric power industry into electricity supply activities and electricity support activities. Under the old, and current, law of 1985, electricity supply activities are organized by the Government and carried out by state owned companies, known as "*BUMN*", established as the holders of the so-called Electricity Undertaking Authorization (an authorization granted by the Government to state-owned companies assigned the sole task of providing electricity for public use), whereas electricity support activities may also be undertaken by the Government in cooperation with private business entities.

It was the intention of the 2002 law to open up the electricity industry to international investment and to introduce the concept of "unbundling" with respect to the manner of how electricity supply activities were to be organized. The unbundling system allows electricity supply activities to be performed separately by multiple different business entities. Operation of electricity power plants would be open to free competition among business entities, regardless of whether

such entities were state-owned or privately-owned. The Government had hoped that with this kind of structure, foreign investors would participate in providing electricity supply which, in turn, would create a fair and competitive market yielding the best products for the lowest prices.

This new concept was viewed by the Constitutional Court as a threat to state-owned companies because private companies are in better position to compete in the market, having available better management, technology, and finance. Furthermore, this condition would result in uncertainty in the provision of sufficient electric power to all layers of society and all parts of the archipelago. Private companies are likely to concentrate on providing electricity to big cities rather than to many remote areas.

It is also possible that underlying this decision resides some apprehension resulting in part from the debacle of the private power contracts awarded to foreign conglomerates in the early 1990's. The suspension of these contracts, at the insistence of the IMF after the onset of the economic crisis of 1997 and 1998, resulted in disastrous arbitration awards in favor of two hasty questionable groups, although the other 20 or so investors in this developing economy kept faith with Indonesia, renegotiating their contracts to more feasible, affordable terms, and continue to provide much-needed power to this day.

The annulment of the new law notwithstanding, the Constitutional Court has stated that private business entities, both national and foreign, may cooperate with state-owned companies in supplying and generating power for the public by providing financing or by setting up joint venture Indonesian companies, with state-owned companies taking a majority position.

The Constitutional Court reinstated the old Electricity Law of 1985 in an attempt to maintain legal certainty following the annulment of the 2002 law, but it allowed that contracts entered into under 2002 law, prior to its annulment, will remain in effect. New contracts made thereafter will be governed by the 1985 law. As a

decision of the Constitutional Court is final and binding and not subject to appeal, the 2002 law is now a dead issue. It is nonetheless hoped that it will not be long before an updated new law is drafted, and promulgated, to better meet Indonesia's energy needs for the 21st Century.

IV. Concluding Remarks

Prior the annulment of the competition-oriented electricity law of 2002, the trend in regulatory regime in the sector of oil, gas, and energy had sparked new hope for a more open and competitive market, which eventually would have yielded increased investment in the area. However, the annulment may have marred the spirit of opening up the market to foreign participation. It is feared that the annulment of such law may be viewed by foreign investors as a setback in the Government's plan to eliminate monopolies enjoyed by state-owned companies in many key sectors. It is hoped that the Government will give further consideration to what was the intention of the constitutional provisions relied upon and how these can be applied in a manner less disadvantageous to Indonesia's need for foreign investment in its infrastructure and essential services, for the benefit of the populace.

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